RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**
P.O. Box 1759, La Jolla, California 92038
36 Letters per year — $150 Annually
Registered with the Securities and Exchange Commission

March 15, 1978 **LETTER 724** Mar. 3, DJIA 747.31; PTI 694; A-D Ratio –22.30
Mar. 10, DJIA 758.58; PTI 707; A-D Ratio –21.48

RYAN ROBERT RUSSELL was born at exactly 12:04 am on March 7. A child of inflation, he weighed in at a whopping 9 pounds, 11 ounces and was 21 inches long (that's long). I was in the delivery room, and I saw it all. When halfway out of the womb, Ryan showed his colors. He grabbed the doctor, threw him into a Japanese key-lock, and tossed the astounded physician halfway across the room. Sliding onto the delivery table, he told a cowering nurse, "If I need help, I'll ask for it." Half an hour later he uttered his second full sentence. It was, "Did anybody catch the afternoon gold fixing?" That's my boy!

No, all kidding aside, the weight and length of this moose is correct, as stated above. He's beautiful, Paula was fantastic, and I was there during the whole thing–right through to the delivery. It was an amazing experience, fabulous. I recommend a baby for all Americans of 50 years of age or older!

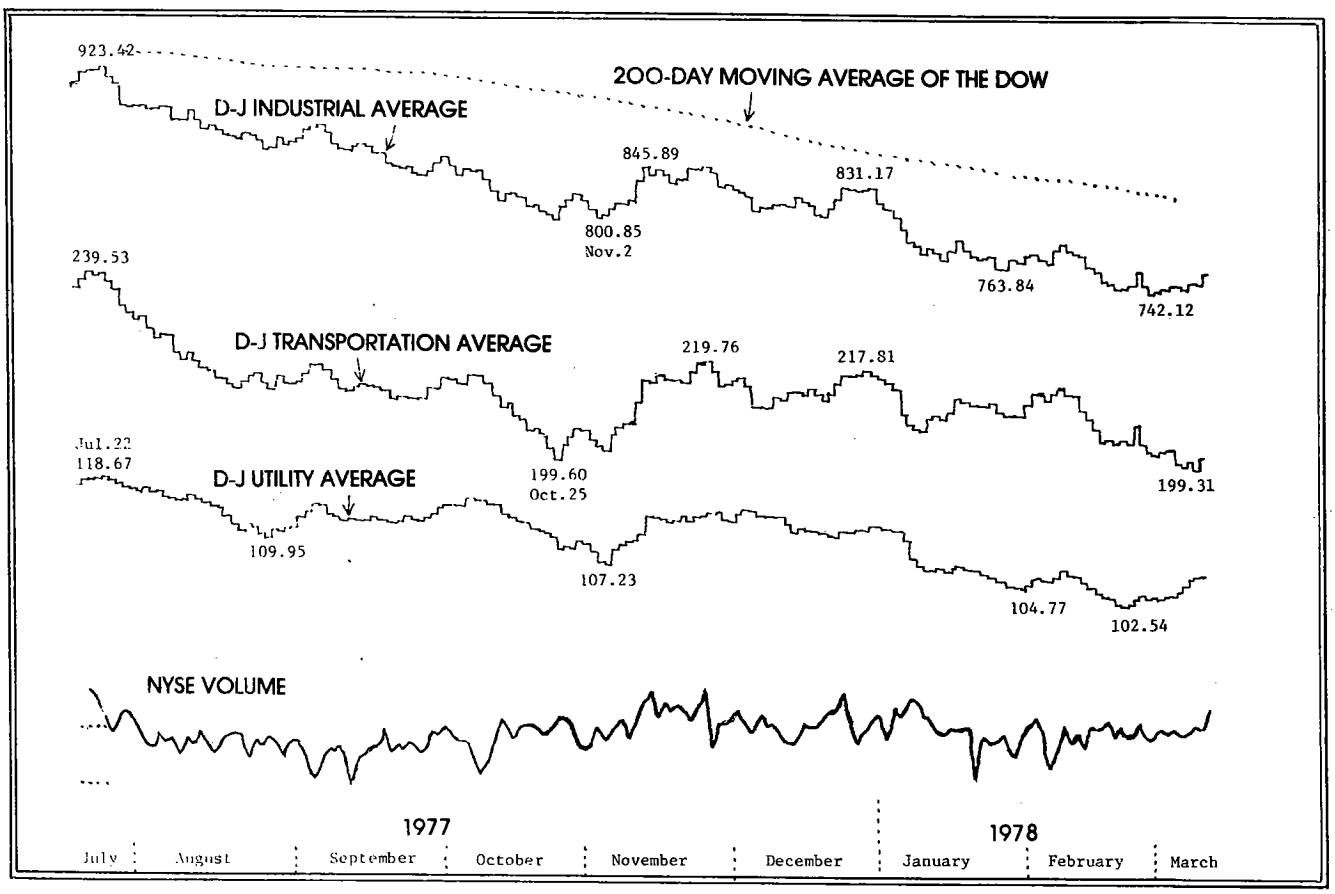
BACK TO THE MARKET: Have you ever wondered why the stock market is so difficult and frustrating? Here are a few observations. (1) Two-thirds of the time the market is not doing anything definable from a trend standpoint, it's simply starting, stopping, backing and filling, going nowhere.

(2) The other third of the time the market is moving in an obvious bull (or bear) trend. BUT it is the nature of a bull market to keep us either (a) worried, or (b) out on the sidelines. By the same token, it is in the nature of a bear market to keep us either (a) hopeful or (b)buying the periodic rallies.

(3) In the stock market the big money is made buying and staying with the major bull swings. But ironically, most people (a) get caught in the small movements or (b) stay out, or are frightened out, of the big advances.

So where are we now? What is the market trying to "get us to do" **now**? I would say that this bear market is telling us, "Come in, the water's fine." After all, the bad news is all over the headlines. Coal mine mess, inflation at double digit levels again, wishy-washy President who seems to be taking "incompetence" pills, weak dollar, rising gold, leading indicators wilting, auto sales sliding, African situation worsening, no semblence of a real energy bill, and on and on. But in the face of all this, the market "appears to be" groping for a base. And to be honest about it, I've never seen a market that was trying so hard to push higher. I mean this market is really trying!

In the last Letter I drew particular attention to the Dow **744** level. I wrote that the 744 level represents a Fibonacci 61.8% correction of the entire 1974 to 1976 Dow rise. As such, 744 would be a logical starting place for a rally (but I also said that such a rally would ultimately prove to be a "trap" for the bulls). So let's review the nearby situation and see if we can make some sense out of it.



First, we have a February 22 Utility low of 102.54–with a persistent little Utility uptrend since (see page 1 chart). We also have a February 29 low of 772.12 on the Dow, with a little uptrend from there. And on March 6 the Advance-Decline Ratio closed exactly 4/100th's above its low of last October, but note that the A-D did **not** break the October low. Finally, just to make matters a bit mystifying, on March 9 the Transportation Average sank below its 199.60 low of last October. Transports thus gave a belated confirmation of the recent Industrial bear market lows.

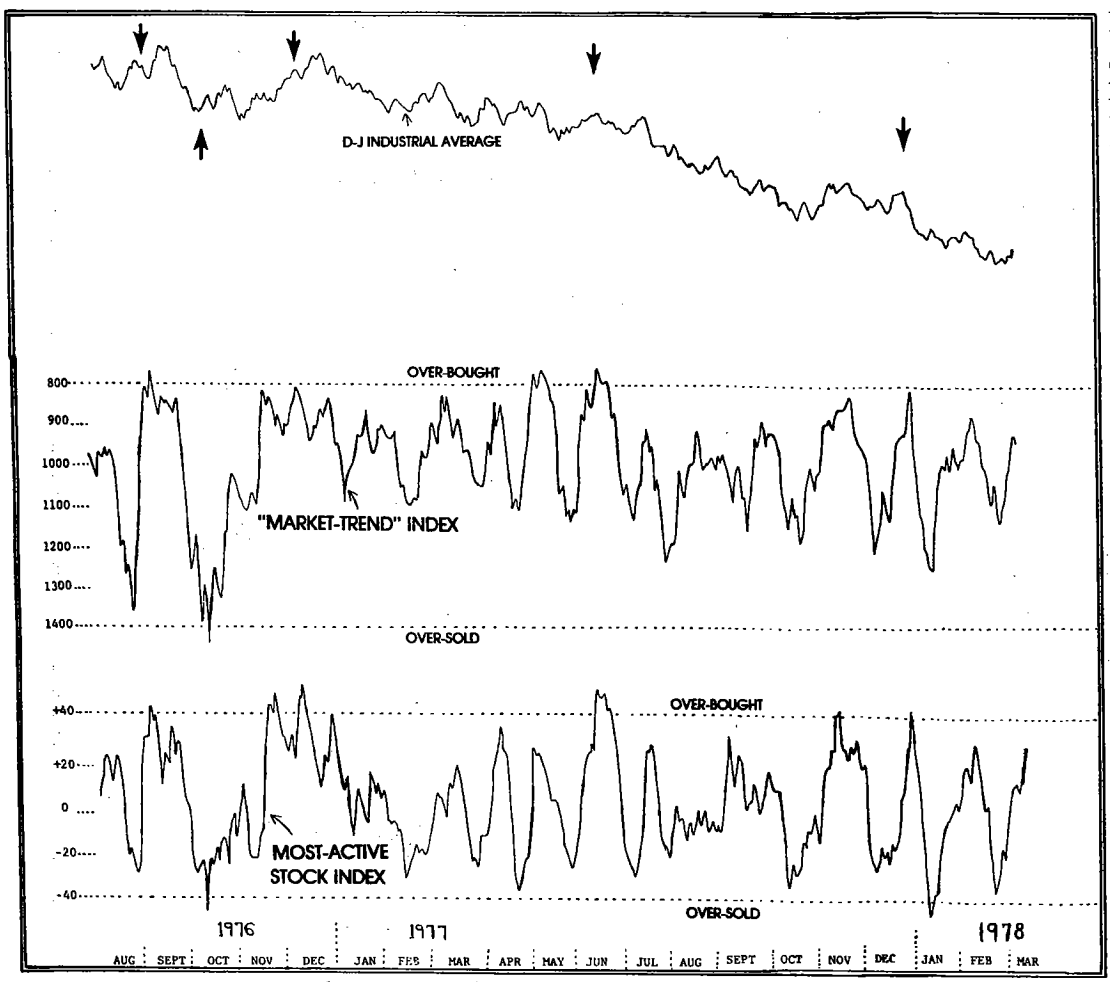
This is one of those times when I feel neutral on the intermediate term trend of the market. We have a number of conflicting technical signals, some bullish and some bearish. I believe that the ability of the A-D ratio to hold above its October low has positive implications for the near term, but for the longer term I believe the A-D will go considerably lower (along with most stocks). As far as the new low on the Transports, I feel that this low possesses no particularly bearish implications for the market over the near term. But if you study the Transport chart on page 2 of the last Letter, you will see that Transports could fall apart during the next important market decline. Thus the new Transport low is a long-term bearish omen.

Following its February 28 low of 772.12, the Industrial Average reversed character by refusing to follow the decline in Transports and the A-D ratio. When the weakest segment of the market (which certainly has been the Dow Industrials) resists declines in the other indicators, it's usually time for a rally, and that's what we're getting now. Another thought occurs to me and it's this. I think people are almost tired of bad news, they're tired of watching the stock market flounder, they're tired of watching Jimmy Carter flounder, they're just plain tired, and they are probably ready to try their hand at a rally–any kind of rally. A hint of this came on Friday, March 10 as 7 million shares flooded the NYSE during the first hour of trading.

What are my "objections" to a rally from here? None at all; my objections have to do with **playing** a rally from here. First, it should be remembered that bear market rallies often look great, even better than the real thing (by the real thing I mean an advance in a bull market). But bear rallies often end as quickly as they start, and they therefore can be deceptive and costly.

I will also add that this rally, like all the others of the past 15 months, developed without the phenomenon I've been talking about for so long–an over-sold market bottom. Thus, any sustained advance from the Dow 744 level will find the market over-bought and vulnerable within a matter of a few weeks.

BOTTOM-LESS: I think the accompanying chart illustrates very well the story of this market since late-1976. The story runs this way: the market rallies to an over-bought level, and the Averages then turn down. But Wall Street remains optimistic, and the decline refuses to generate any heavy selling pressure. An over-sold situation therefore fails to develop. A new rally occurs, and in short order the market is over-bought again. BUT, note that each succeeding over-bought level finds the Averages at lower levels.



My two indicators (which, by the way, must always **confirm each other** for valid readings) have faithfully and accurately told the story. During 1977 these two indicators flashed three over-bought signals (the down-arrows on the chart) but never an over-sold signal. How long can this unusual situation go on? As long as investors remain complacent, I would guess. The indicators are in no hurry, so why should we be?

My experience with these two indicators and the rationale behind them leads me to two inferences: (1) Serious investors are no more apt to buy the market now than they were two months ago or five months ago. The only thing that will bring the "big, important money" into this market is a fully over-sold situation brought on by heaving selling. (2) The longer this market resists going fully over-sold, the more drastic the ultimate over-sold situation will be when it finally arrives.

Conclusion: Within a few weeks my two indicators are going to move to the over-bought zone again, at which time this bear rally will be in trouble. In the meantime, I think traders are so tired of waiting for a real bottom that they are ready to play anything on the upside. It's sort of the Vegas psychology applied to Wall Street. You realize that there's a good chance you'll lose money, but "any action is better than forever sitting on your hands." Of course, I don't see it that way. I'm one of those weirdos who likes to come out of the market with more than I put in. And that means waiting for an over-sold situation.

BARRIERS: I've been doing a lot of thinking about barriers in the stock market and elsewhere. If you study a long-term chart of the D-J Industrials you will see that 1000 has been an amazing barrier on the upside. Since 1966 the Dow has tried at least eleven times to rally above the 1000 level and hold there. But each time the 1000 barrier turns the Dow back.

By the same token, "half a thousand" or 500 has proved to be a barrier on the downside. In 1966 the Dow plunged to the 735 level. In 1970 the Dow sank to the 635 area. And most recently, in 1974, the Dow smashed to the 575 level. But each time the 500 level has held.

Ultimately, there will be a conclusion to the great 500-1000 enigma. The Dow is either going to push decisively above the 1000 barrier or it is going to smash decisively below the 500 level. The way things are progressing, if I had to guess, I would say that 500 is going to go before 1000. But that's just a guess, and I may be forced to revise my thinking in a year or so.

Yet it is the very concept of barriers that interests me. The concept interests me because we (you and I) tend to set up barriers in our own lives and in our general thinking. And the fact is that the history of human progress is a history of barrier-breaking.

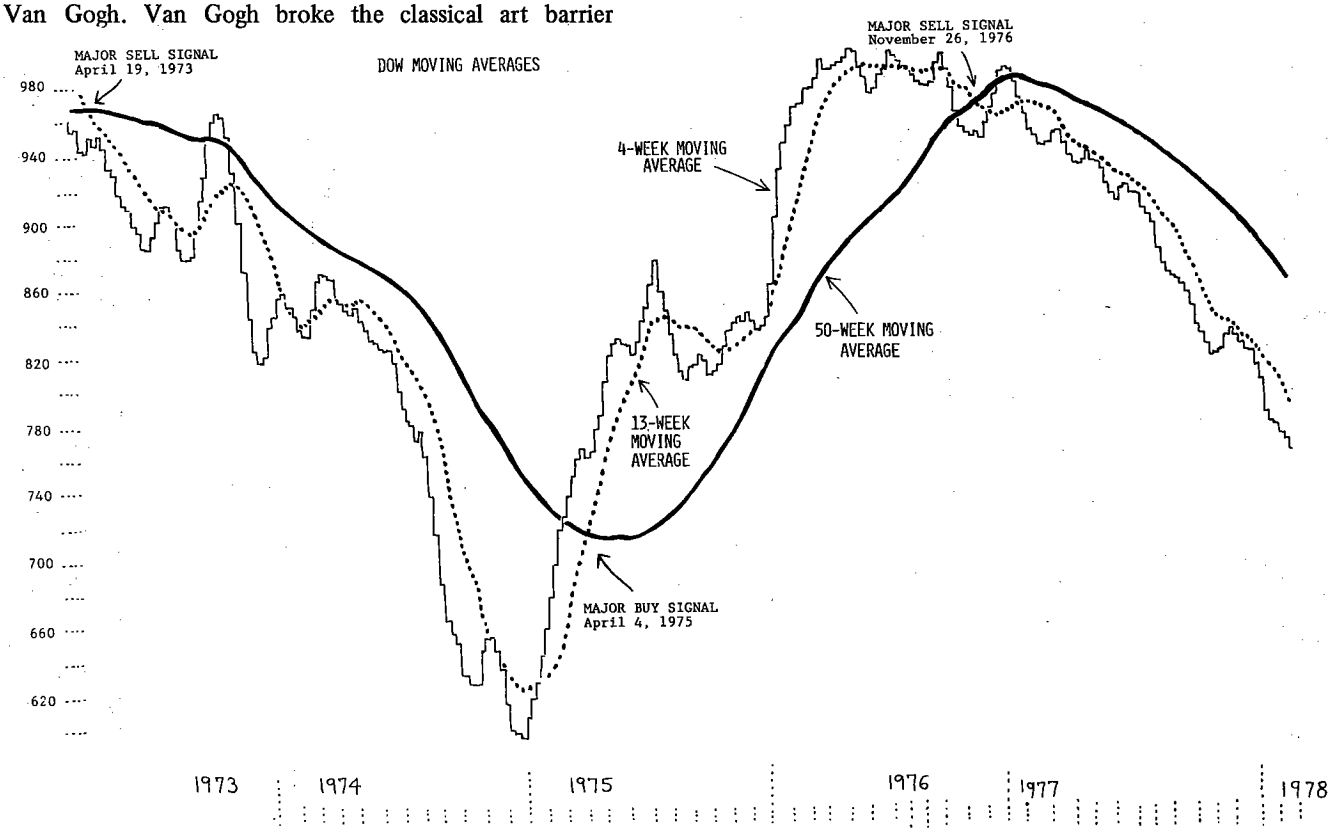
For instance, I have always been fascinated by the great Dutch artist, Van Gogh. Van Gogh broke the classical art barrier by painting his visions on canvas in a totally new, totally personal "impressionistic" way. Van Gogh sold only one painting in his life (any of his canvasses would command a fortune today), but Van Gogh's genius changed the course of art forever.

There are dozens of other barrier-smashers. There's Freud, the crotchety old Viennese neurologist, daring to state that a whole new world lies beneath the conscious mind. In a series of books and papers, Freud tore away the forbidden barrier of the unconscious mind, thus opening up the field of modern psychology. Then there's the great extraordinary physician, Louis Pasteur, breaking the disease barrier with his amazing vaccinations and inoculations, ending the dreaded scourges of rabies and anthrax.

Turning to recent history, we saw Roger Bannister, a Britain, amaze the world by breaking the four minute mile barrier, running the mile in 3 minutes and 59 seconds for the first time in history. After that psychological barrier was cracked, dozens of other men ran the mile in under four minutes. Then we broke the space barrier, a barrier which was cracked when Neil Armstrong took his extraordinary "walk on the moon." Prior to that we saw the sound barrier broken as flyers pushed their planes at Mach 1 and better. Older readers remember the shock and pleasure of seeing TV pictures in their living rooms in 1946 as the space-sight barrier was broken.

But just as interesting as the cracking of actual physical barriers are barriers or LIMITS that you and I place on ourselves. Almost daily we hear someone say "I can't do that" or "I know it's impossible" or "I've tried, and I don't think it will work." And my silent (or sometimes verbal) reaction is, "Try it–do it, why put up all those barriers and defeat yourself before you start?"

Now I'll reveal something about myself and my own barriers. Perhaps this will sound a bit corny and not mean very much to you, but here goes. About eight years ago there came a time when I was struggling with the market and my own life and



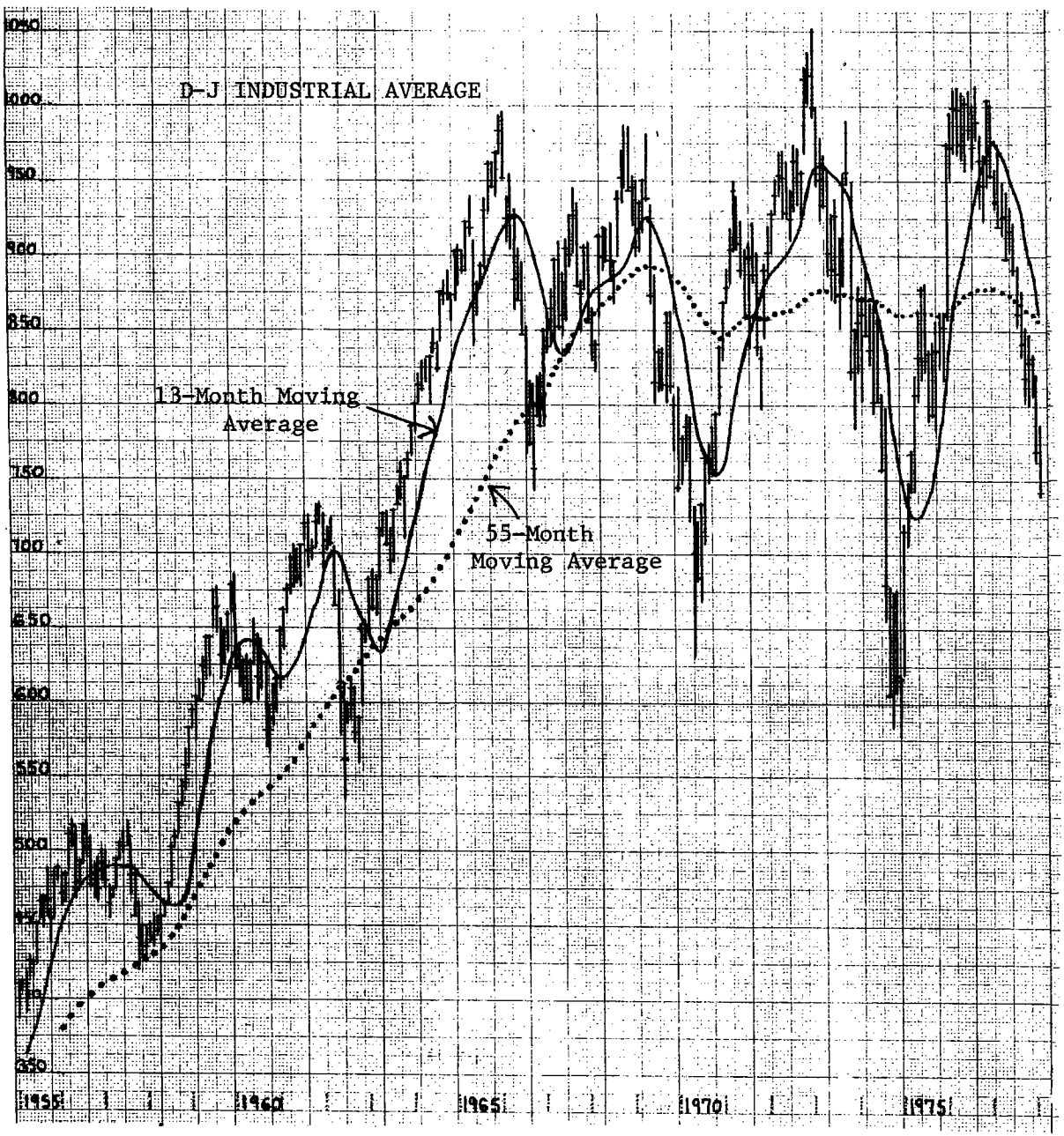
just about everything else. Finally, one day I came to the point where it all seemed impossible–just too much for me to cope with. I remember that on that day I slumped down in a chair and mumbled, "I can't do it. It's (meaning my life) too much. I really think I'm going to give up." Life seemed an impossible barrier to me.

At that point, in that instant, I realized that what was happening was that I just could not "hold myself up" any longer. And in that same instant, I suddenly realized that every breath I took, every thought I had, every move I made was by the grace of God.

Then my mind turned to a strange incident that had occurred the day before. I was heading home on my BMW motorcycle. It was an open stretch of road on Pacific Beach when without warning a delivery truck next to me (we were doing about 45 MPH) screetched its brakes, veered to one side, then rolled violently over and over. I pulled over as far as I could to the right (without hitting the curb), and the sliding truck touched my cycle cylinder with a loud "tink." Clearly, if I had been two inches closer to the truck, I would have lost a leg or perhaps my life. I had a strange almost triumphant thought at that time, but I couldn't put it into words. The next day I knew what the thought was. It was that I was only alive by the grace of a greater power, and it was that power that was holding me up, directing me, teaching me, and sparing me.

In looking this over, I realize that this piece is rather "exotic" for an investment advisory service, but I wanted somehow to get it off my chest, and that did it.

Now to get back to the market again. I opened this section talking about barriers, and one barrier I recently have decided to work with is very long-term moving averages. Most readers are familiar with my study of the three moving averages of the Dow, the long-term or 50 week MA, the intermediate-term or 13-week and the shorter-term or 4-week MA. I am including my chart (page 3) of those three Averages, and here you can see that incredibly, they retain their bearish positioning. By that I mean that the 4-week MA is below the 13-week and the 13-week is below the 50-week and all three are still declining. Furthermore, the distance between the 13-week and the 50-week has increased to 73 points, the largest spread since the 13-week MA gave its major bear signal by dropping below the 50-week on November 26, 1976 (see chart).



This is one of the worst Dow slides in stock market annals, and what is so extraordinary is that the shortest term MA, the 4-week MA, has not corrected (it corrects by rising temporarily above the 13-week MA).

But the barrier I have been thinking about in relation to moving averages has to do with **length** and **timing**. In puzzling over the whole concept of moving averages, it occurred to me that almost all the widely followed moving averages are less than one year in

length. We see charts of 200-day MA's, 39 week MA's, 60-day MA's and even my own 50-week MA. "But what about the very long term?" I thought. "What would a full-cycle MA look like–say a MA geared to a recognized stock market cycle?"

I had one of my office workers (thank you, Pat Auer) sit down with a calculator and run some really extended moving averages such as a 13-year MA, a 55-month MA, a 21-month MA. Then (with the help of Dean Witter's Jon Strebler) we charted these MA's. And I am including one of the most interesting charts, one that I am going to up-date frequently in these reports.

Here (page 4) we see a monthly chart of the Dow with the 55-month (dotted line) and a 13-month MA (solid line). I used 55 months, because this is equal to 4.58 years, comparable to the widely accepted 4.5 year market cycle. The 13-month figure was used because it is about a one-year cycle. One year is a common swing in a primary bull or bear market. Furthermore, both 13 and 55 are in the Fibonacci series.

At any rate, I thought the results of this study were quite fascinating. Note that the 55-month MA hit a peak of 890 in 1969. Since then it has been moving sideways. More recently it has started to decline. Thus, it appears as if a gigantic roof has formed over the Dow in the 850-900 area. Very shortly the 55-month MA will break below 850 to its lowest level in a decade! This has extremely bearish connotations.

The 13-month MA has been swinging wildly along with the various major moves in the Dow. Within a few months the 13-month MA is going to plunge below the 55-month MA, at which point the whole picture from the standpoint of these long-term MA's is going to look ominously weak.

Contrast the powerful action of the 1954 to 1968 rise with the picture today. During the period up to 1968 the 13-month held persistently above the 55-month MA, thereby implying a rock-strong technical situation for the Dow. In 1969 the 13 Month MA plunged sharply below the 55. Since then the picture has been one of deterioration and ebbing strength.

One final observation: I refer to Edson Gould's "rule of four's." This rule states that the market can attempt a course of action three times running and fail each time. But on the fourth try it will either make it big–or fail big. Note that the Dow and the 13-month MA have tried three times to march through the 1000 barrier. The fourth failure occurred during 1976-77. This, then, should be the failure that qualifies as "the big one."

GOLD & INFLATION: The new wholesale Price Index figures are out, and the rate is 13.2%. This roaring rate should shortly be translated into double digit inflation on the Consumers Price Index. One thing is obvious, the Government's printing press efforts at holding back the forces of secular business decline is not really helping business. It is not boosting business confidence or earnings. But it is driving prices up and away.

Editor Tony Boeckh, in the latest *Bank Credit Analyst*, notes that there are three principle areas which reflect the forces of inflation: (1) A decline in the external value of the currency, (2) Accelerating wage and price rises, (3) Excessive personal consumption along with speculation, rather than constructive productive development. All three of these phenomena are now in force with the second particularly gaining in momentum. Boeckh states that the public has now grown quite sophisticated and can be expected to move rapidly to protect itself. Such action by the public will set off counter-measures by governments which seek to mask the results of their inflationary handiwork.

I've talked in past Letters about many of the categories of "protection" including houses, coins, diamonds, stamps, antiques, silver and gold. In my mind, the one item most accessible to the average person, the item which presents fewest problems, the item which possesses indisputable value, the item which represents an undeniable "store of value" and is part of the reserves of every major nation in the Free World–is gold. Silver is nice, but it is not a reserve metal (and it is also affected by consumption patterns). Diamonds may be a girl's best friend, but they can also present a problem in both the buying and selling areas (no matter what they tell you, if you're an amateur it's hard to buy 'em right, and just as hard to sell 'em right). In my humble opinion, the surest and safest protection against government atrocities in the monetary area is –"The Big G," Gold. Gold is an item recognized everywhere; you can sell a buck's worth or a million dollar's worth anywhere, any time, and fast.

Next thought: I've said this before, and I want to repeat it. Governments will do whatever they have to–to perpetuate themselves. The debt of the US is so huge, so outlandish, that this Government now has only two alternatives–inflate or die.

But the US can never pay off its mountain of debt without bringing on a monumental deflation and depression. Thus, we can expect the US to pick the path which is the more politically palatable, inflation. The Bank Credit Analyst states, that ". . . *it appears that the policy of forced inflationary growth in the US will be continued.*" But the Analyst also states, *"It is evident that the risks associated with the once-in-a-lifetime supercyclical problems....are growing."* In other words, we are slowly but relentlessly moving towards the abyss.

When that happens, young (and old) mens' fancies lightly turn to thoughts of gold. So let's think about gold (and for the benefit of new subscribers I recommend 10 to 20% of your assets be held in gold coins or bullion). On March 8, gold hit a bull market high of 190. It then backed off. The reason for the retreat is both logical and easy to understand. First, gold has moved up very far and very fast. For instance, note on the page 6 chart that gold has rallied sharply above its 13-week moving average which is now 173. Gold is even holding above its shorter-term 4 week moving average, which now stands at 182. Thus, gold is holding above all three moving averages, and the three MA's are rising, a bullish situation for the intermediate and longer term.

Now let's study gold from another standpoint. Look at the point & figure chart of gold. Each box on this chart equals $2, and only rallies and declines of 6 points or more are depicted (this severely **concentrates** the price action). Note that the most recent rise in gold took the metal from the 158 box to the 190 box, a rise of 32 points without a 6-point correction. This produced a kind of "upward spike" in gold, and such movements usually give way to a correction (or a consolidation where the technical structure continues very powerful).

I have drawn a dotted "resistance line" connecting the recent 190 peak and the earlier 186 peak. My feeling is that a consolidation here could be very constructive. Any consolidation in say the 180 to 190 level would build a pattern that would resemble a gigantic "head-and-shoulders bottom." If this happens, the whole picture will appear spectacularly bullish. Following such a

potential consolidation, a new rise above 190 would set gold in line for a new thrust into the mid-250's to 300. But first, I would like to see a bit of consolidation or at least some "holding action" in this area.

Now for another facet. Currently, there exists a perfectly massive short position against the dollar. This short position was assumed by many multi-national corporations and many banks (including the overseas branches of US banks). I believe this short position is going to be hit hard, driving the dollar up against the so-called hard currencies. Last week, in fact, we saw the dollar surge while the Swiss franc fell. This presented a most interesting picture which I alluded to in previous Letters. The picture I am talking about is the price of gold in terms of hard currencies and specifically the Swiss franc.

Note on the page 6 chart that gold "broke out" in terms of the franc in early 1977 (trendline 1), then fell back. But last week gold again broke out in terms of francs as identified by the arrow at trendline 2. I believe we could soon see gold rise to a new 1977 high against the Swiss franc. If that happens, we could also see a real move by hard money holders into gold. This would mean that all currencies, the hard and the soft, the dollar, the yen, the mark, the franc, the ruble, the dinar, all will be sliding against gold. It has been said that all paper currency is eventually rendered worthless. "Yes," I think to myself, "it's only a matter of the timing."

Note: For subscribers in the Southwest who are wondering where to buy coins, I can suggest my friends at North American Coin & Currency, First Nat. Bank Plaza, 100 Washington St., Phoenix, AZ 85003. They also offer excellent publications on silver and gold.

LATE NOTES: Optimists are talking about the "great values in the stock market," and they point to the stalwart performances on the AMEX and NASDAQ. I prefer to watch the big money and the big trends. For instance, IBM's market value alone is roughly the same as the value of the entire AMEX. And IBM is now breaking down from a massive top formation. In the meantime, the March 13 Wall Street Journal mulls over the very strong possibility of a $100 billion-plus Federal deficit, a possibility which I have been mentioning for months. A deficit of this magnitude would give us some fascinating interest rates before 1978 runs out.

Any concerted upside action over the next week or 10 days will move my page 2 indicator chart to the over-bought position. So let's be guided accordingly.

THANKS: I truly want to thank all the friends who sent cards and letters regarding "little" Ryan. I appreciate all those good wishes as does my wife, Paula.

NEXT MAILING: March 24th